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Introduction

Chairman Gallegly, distinguished members of the Committee on International Relations, thank you for the opportunity to testify on U.S. foreign assistance programs for the countries of Europe and Eurasia.

When the Berlin Wall fell in 1989 and the Soviet Union collapsed in late 1991, the Europe and Eurasia region became a new frontier for the United States Government. Your committee responded through the authorship of the Support for East European Democracy (SEED) Act of 1989 and the Freedom for Russia and Emerging Eurasian Democracies and Open Markets (FREEDOM) Support Act (FSA) of 1992. From the inception of these acts, USAID has been the main federal agency managing programs to promote democracy and human rights, to introduce and institutionalize a market economy, and to alleviate the social and humanitarian problems in the former communist states of Europe and Eurasia. Our underlying objectives in the region have been and continue to be freedom, peace, prosperity, and regional stability.

Since we initiated work over a decade and a half ago, extraordinary progress has been registered across the region, particularly in the democracy/governance and economic growth areas, though much remains to be done in some countries. Notable achievements include: (a) the re-emergence of positive economic growth since 2000 after years of contraction, (b) Freedom House's ranking of 19 of the former communist states as free or partly free with a return to communism unlikely in most countries, (c) Three peaceful democratic breakthroughs: Georgia's "Rose" Revolution, Ukraine's "Orange" Revolution, and Kyrgyzstan's "Tulip" Revolution, (d) the significant integration of a number of the region's states into regional and global organizations such as the World Trade Organization (WTO), European Union (EU), and the North Atlantic Treaty Organization (NATO). In fact, performance has been sufficiently good that we have graduated country programs for the eight Central and East Europe (CEE) Northern Tier countries, enabling the closure of the five Missions that served these countries.¹ Three more country programs and their attendant Missions will close over the next several years – in Bulgaria, Croatia, and Romania.

Still a number of challenges persist -- in encouraging economic growth, developing democracies and promoting respect for human rights, improving health, and increasing educational levels.

- **Developing Democracies and Promoting Human Rights.** The seeds of democratic change are slow growing but can produce strong results over time – patient support for

¹ The Northern Tier consists of the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, and Slovenia.

democratic institutions and human rights in Georgia, Ukraine, and Kyrgyzstan gave their citizens strong political voices. Continued support for the persistent voices of freedom and democratic reform – civil society groups, democracy and human rights advocates and movements, and independent media – will prove decisive.

- **Encouraging Economic Growth.** Unemployment and the lack of opportunity make a society vulnerable to extremism. A vibrant economy provides jobs and incomes. It allows people to buy houses, farms, and shops and gives them a stake in the future. Job growth that benefits all regions and all ages, particularly the young, is vital to the long-term stability of our region.
- **Improving Health.** Collapsing populations, eroding life expectancies, and rising rates of drug abuse and HIV/AIDS and tuberculosis are too common in our region. To be viewed as viable, post-Soviet states must ensure that basic health care is available to their people. Improving health status, therefore, is critical to political stability and a significant challenge.
- **Increasing Educational Levels.** The erosion of educational levels is seen by many as a symptom of state failure. Lack of educational training also leaves youth ill-prepared to fill today's job needs. Increasing educational attainment, as well as adapting curricula in ways that prepare students to succeed in market democracies, is a significant challenge to our countries.

The Geopolitical and Security Context

Since the September 11, 2001 attacks on the United States, the geopolitical and security importance of the countries of Central Asia and the Caucasus has increased dramatically. These states constitute the front line in helping to create stability in a region vulnerable to extremism, drug trafficking, and terrorism. Countering authoritarianism, human rights violations, and economic stagnation, which together provide fuel for domestic unrest, extremism of various sorts, and international terrorism, is key to protecting U.S. interests in the region. Further, the Caspian region's tremendous oil and gas resources add to its importance to the United States. The proven oil reserves of just two states in the Caspian Sea basin, Kazakhstan and Azerbaijan, are just slightly less than those of the United States. Also, Kazakhstan's Kashgan field is perhaps the largest petroleum find in 30 years.²

In the Southern Caucasus, the region's significant Caspian energy reserves, unresolved ethnic and nationalist conflicts, and the threat of international terrorism underscore the states' geopolitical and security importance to the United States. Both Azerbaijan and Georgia provide the routes for the recently-dedicated Baku-Tbilisi-Ceyhan oil pipeline and the soon-to-be-completed South Caucasus Gas Pipeline, which together will bring the Caspian region's vast oil and gas resources to world markets. Also, an uneasy stalemate over Nagorno-Karabakh exists between Armenia and Azerbaijan. In Georgia, separatist movements in Abkhazia and South Ossetia threaten the integrity of the state internally, while the conflict in the neighboring Russian Republic of Chechnya places pressure on regional stability. The simmering conflict in Chechnya also has been tied to terrorist incidents, including the downing of two civilian airplanes, bombings in the Moscow metro, and the tragic attack in Beslan.

² *National Energy Policy*, pp. 8-12, Report of the National Energy Policy Development Group, GPO: May 2001.

The internecine warfare accompanying the collapse of the former Socialist Federal Republic of Yugoslavia in the 1990s not only caused humanitarian catastrophes but also threatened the peaceful democratic and economic transitions in neighboring post-communist states. The United States and its NATO allies intervened with military, diplomatic, humanitarian, and technical assistance to protect human rights, establish peace, and lay the foundation for sustainable democracies and open market economies. While marked progress has been made in the Balkans since the Milosevic era of the 1990s, ethnic and nationalist tensions and human rights abuses combined with ongoing economic hardship and soaring unemployment continue to drive instability, and the area remains an important geopolitical and security concern to the United States.

Trade with and investment in the E&E region are certain to increasingly benefit the United States. From natural resources to industrial equipment to the service sector and beyond, the United States is broadening its trade relationships with the region. U.S. exports to the region totaled roughly \$7.1 billion in 2003 with direct investment of no less than \$4 billion in that same year. USAID's work to combat corruption, promote enforcement of contract and other commercial laws, help E&E countries join the WTO, and lay the foundations for the private sector have helped pave the way for American trade and investment.

Extremism threatens to destabilize several areas within the E&E region. In particular, we must monitor the role of political and radical Islam and the conditions that permit Islamic extremism to flourish. USAID will continue to play a vital role in promoting democracy and respect for human rights in the region. Not only is this the right thing to do, but it avoids adding fuel to the fire for any kind of extremism.

In the National Security Strategy of September 2002, development was officially recognized for the first time as one of the three pillars of national security (along with defense and diplomacy). This represents a profound new understanding of how dangerous failed states are to the security of the United States and the rest of the world and how important development assistance is in dealing with failing and failed states. We cannot ignore those regions in Southeastern Europe and Eurasia struggling to escape the debilitating legacy of communism. Thus, the work of USAID to firmly root democratic, economic, and social reforms in formerly communist, corruption-ridden Eastern Europe and the former Soviet Union is central to U.S. security.

Indeed, President Bush's National Security Strategy already has yielded fruit in Europe and Eurasia. E&E countries are becoming America's allies. Bulgaria, Estonia, Latvia, Lithuania, Romania, Slovakia, and Slovenia joined NATO in March, 2004; the Czech Republic, Hungary, and Poland joined the Organization in 1999. The backing of the region's states in the international war on terrorism and of U.S. policy also has been strong. Indeed, nineteen recipient countries in Europe and Eurasia have been active supporters of Operation Iraqi Freedom, Operation Enduring Freedom, and/or the International Security Force in Afghanistan in 2004.

Finally, America's most important foreign policy and security interest in the region is its relationship with Russia. The United States needs Russia as a strong, reliable, democratic,

long-term partner in addressing issues of mutual and global importance such as non-proliferation, counter-terrorism, human trafficking, and HIV/AIDS. Russia is also an energy powerhouse. In 2000, it was the world's second largest exporter of oil, and it holds one-third of the world's proven natural gas reserves.³ Assistance to Russia is not just a program of traditional development. It provides a key strategic tool for focusing attention on neglected issues and encouraging Russians to work with us in areas vital to our national interest.

Resources

In coordination with the State Department's Assistance Coordinator for Europe and Eurasia (EUR/ACE), USAID has played a lead role in planning and implementing assistance programs for the E&E region. In FY 2005 -- the last year for which funds have been appropriated, USAID administered two-thirds of both SEED and FSA funds, 66% in the case of SEED and 67% for FSA. From the inception of the SEED and FSA accounts through FY 2005, Congress has appropriated a total of \$17.3 billion in assistance under both accounts to the region. This excludes this year's \$70 million Ukraine, Belarus, and Northern Caucasus supplemental appropriation. Of the supplemental funding, \$60 million is being used to help the new democratic Government of Ukraine fight corruption, reform the economy, reach out to civil society in the eastern and southern parts of the country, and prepare for the upcoming Parliamentary elections. In Belarus, \$5 million is being used to promote free and fair Presidential elections through improving the political process, increasing access to information, and supporting civil society. In the northern Caucasus, \$5 million is being used for humanitarian aid, conflict mitigation, and relief and recovery assistance for needy communities.

The FY 2006 request, including \$382 million for SEED and \$482 million for FSA, will be directed to those remaining gaps defined by the Bureau's Monitoring Country Progress (MCP) system, taking into consideration the best judgment of EUR/ACE, Mission, and Bureau staff on the recipient's commitment, the likelihood of progress, and the need for continued investments.

Joint State Department/USAID Strategic Plan

In order to make the new focus on development in the U.S. National Security Strategy operational, the U.S. Department of State and USAID developed a Joint Strategic Plan (August 2003). It identifies four strategic objectives, twelve subject areas, and thirteen priorities. USAID's E&E Bureau focuses on mainly three subject areas under the objective "Advance Sustainable Development and Global Interests." These are:

- economic prosperity and security;
- democracy and human rights;
- social and environmental issues.

In addition, USAID programs in the E&E region advance the joint strategy's subject areas of regional stability, international crime and drugs, humanitarian response, and public diplomacy.⁴ We promote regional stability through our conflict resolution work -- most of

³ *National Energy Policy*, pp. 8-12.

⁴ The other joint strategic subject areas are: counterterrorism, homeland security, weapons of mass destruction,

which takes place at the grassroots level – in the Balkans, the Caucasus, and Central Asia, and, with Economic Support Funds, Cyprus and Northern Ireland. Our work to help strengthen laws and judicial systems and to promote transparent and accountable public and private institutions contributes to minimizing the impact of international crime and drugs on the United States and its citizens. In the unfortunate cases when it has been necessary, we have provided humanitarian responses due to crises in the Balkans, the Caucasus, and elsewhere. Also, through public outreach in Mission-level strategy development as well as training and exchange programs, our Agency has been involved in public diplomacy and public affairs.

The priorities from the State-USAID strategic plan with high relevance in the E&E region are:

- democracy and economic freedom in countries with significant Muslim populations;
- alliances and partnerships, particularly the strengthening of (a) ties to NATO and the EU and (b) U.S. bilateral relationships with Russia and other E&E countries and allies in Asia and the Middle East; and
- HIV/AIDS prevention, treatment and care.

White Paper

USAID has produced a document “U.S. Foreign Aid: Meeting the Challenges of the Twenty-first Century,” the so-called “White Paper” that provides the framework for all its work. The core goals within the USAID “White Paper” are to: (a) promote transformational development consisting of sustained democratic, economic, and social change; (b) fortify fragile states; (c) support strategic states as determined by the Department of State and the National Security Council; (d) provide for humanitarian help; and (e) address global and transnational issues and other special concerns, e.g., HIV/AIDS. While a number of E&E countries or entities can be classified as fragile (Bosnia-Herzegovina, Kyrgyzstan, Serbia and Montenegro, and Tajikistan) or strategic (Cyprus, Kazakhstan, Kosovo, Northern Ireland and the Republic of Ireland, Russia, Turkey, Turkmenistan, Ukraine, and Uzbekistan), the greatest proportion of activities even in fragile or strategic countries are geared toward transformational development. The White Paper also disaggregates countries by income status (low income, middle income) and commitment to reform (weak, fair, good, top).

Results

USAID is pleased to report to Congress that those programs that we administer are having a profound impact on people’s lives in our recipient countries.

Economic Prosperity and Security:

- In Azerbaijan, our program in agriculture has created over 35,000 jobs, working with over 150 enterprises that have entered new markets. Also, a 100-member Agro-Input Dealers Association we helped create is providing fertilizer, seeds, and other agricultural chemicals to some 40,000 farmers through a network of dealerships associates.
- While we have a number of credit programs in the region that support job creation, at the forefront are those for Russia. Under E&E-supported credit programs last year,

support of American citizens, and management and organizational excellence.

small and medium enterprises were provided over 51,100 loans worth \$83 million. These loans created or sustained some 82,700 jobs by enabling these enterprises to grow their businesses 200 to 300 percent on average.

- To spur much needed investment in Bulgaria that would provide for additional jobs, we helped the country to promulgate a new Law on the Promotion of Investments, develop a National Investment Strategy, produce an “Invest Bulgaria 2004 guidebook,” and promote the institutional development of the National Council for Economic Growth – now the leading body for public-private dialogue and policy formulation. The end product is a share of foreign direct investment in GDP that is approaching 10 percent, the highest in Eastern Europe.
- We have assisted in the establishment of a robust mortgage industry in Kazakhstan, a development that is providing for much-needed housing for the country. Residential and mortgage lending surpassed \$564 million last year, a \$200 increase from the preceding year, owing to the creation of the Kazakhstan Mortgage Company that helped make housing more affordable.
- USAID provided business and trade advisory services to 81 companies in the Kyrgyz Republic, producing portfolio growth in excess of \$18 million that provided for sales increases of 76% and productivity hikes of 66% for assisted enterprises.
- Major advances in business registration were achieved in Ukraine. Our program, active in more than 130 cities across the country, reached 70,000 enterprises via the hotline that was put in place, decreased the cost of business registration by 55% on average, reduced the time to obtain licenses and permits by about 50 percent, and lowered significantly the number of visits to government agencies, in addition to dropping corruption in the process by 84%.
- We helped support the planning for reconnection of the Balkan electricity system with the main EU grid, introduce new energy laws in both Bulgaria and Macedonia, privatize seven electricity distribution companies in Bulgaria, and increase collections by the state electricity entity in Georgia, among other accomplishments.
- With US assistance four of the nations of the former Yugoslavia (Bosnia-Herzegovina, Croatia, Serbia and Slovenia) have this year inaugurated the treaty-based Sava River Commission to manage navigation, trade, flood control and water quality issues on this tributary of the Danube.

Democracy & Governance

Overview: Before the fall of the Berlin Wall in 1989, the former Soviet Bloc nations of Europe and Eurasia were characterized by little to no political freedom, limited independent media, and the existence of few non-governmental organizations. Citizens were ruled by centralized governments and systems of laws that provided no separation of powers nor judicial independence. From its inception in 1990, USAID’s E&E Bureau has been on the cutting edge of democracy programming in these transitional societies. We have been in the forefront for the U.S. Government in designing robust democracy and governance programs that pursue long-term strategic aims of fostering democratic institutions while responding to short-term challenges and opportunities. Our Democracy/Governance successes might be summarized as a three-part story. First, EU accession in eight Central and Eastern European countries resulted in large measure from USAID’s investments and successes in fostering

democratic institutions there. Second, our long-term democracy promotion portfolio throughout the rest of the region has led to demonstrable progress in developing capable, sustainable civil society, media, judiciary, and local government. Third, those kinds of investments plus significant elections support have served as the absolutely indispensable basis for the democratic breakthroughs in Slovakia, Serbia, Georgia, Ukraine, and Kyrgyzstan.

The following represents only a few of the successful highlights of USAID's Democracy and Governance program in the Europe and Eurasia region over the past 15 years.

The Breakthroughs

Slovakia (1998): A successful non-partisan civic education effort was led by 11 Slovak NGOs, entitled *OK '98*. USAID served as the major source of funds for this initiative. The civic campaign included a network of 50 NGOs, across all sectors of civil society, and organized a nation-wide march, and a "rock the vote" campaign that was critical in mobilizing the youth vote that helped to defeat then-President Meciar.

Serbia (2000): USAID's entire DG program, working closely with other donors and implementers, was instrumental in supporting the democratic opposition to Slobodan Milosevic, especially prior to the elections of 2000. A unified candidate was agreed upon with the help of NDI and IRI; the media blockade established by Milosevic was broken via USAID support to the ANEM radio and TV network and local press; USAID supported NGO initiatives to monitor election results and create parallel vote counts that thwarted government attempts to steal the election; independent judges received training and assistance, which was instrumental when the highest court of the land deemed Milosevic's attempt to falsify fraudulent elections results illegal. Mayors of Serbia's largest municipalities, elected in 1996, created havens of democratic opposition activity, allowing for greater freedom of speech and thereby breaking down the strict rules established by the Milosevic regime. Although many challenges in Serbia remain, USAID assistance has provided critical support to democratic activists within Serbia, especially in advance of the pivotal election of 2000.

Georgia (2003): The peaceful protests of the November 2003 Rose Revolution against election fraud ultimately brought down the ailing Shevardnadze government and ushered in the new, reform-minded government of Mikheil Saakashvili. USAID's electoral process support funded a number of activities to improve electoral oversight, such as parallel vote counting, carried out by the Georgian non-governmental organization ISFED that was instrumental in detecting the electoral fraud attempted by the Shevardnadze government. USAID support for independent media helped ensure objective reporting during and after the contested elections. Years of technical assistance to political parties helped strengthen their roots in society. A loose coalition of opposition parties, together with a network of non-governmental organizations, rallied tens of thousands of supporters to demonstrate against the falsification of the 2003 parliamentary elections, leading to the 'Rose Revolution.' However, the challenges of the past – working at the local level and supporting opposition voices – have been replaced by more complex tasks, such as securing a lasting democracy at both the national and local levels, ensuring that civil society, independent media, and political

pluralism continue to flourish, and assuring the rule of law is respected and corruption is addressed. Continued assistance to the DG sector in Georgia will be required in order to fully sustain the revolutionary changes of November 2003.

Ukraine (2004): USAID programs and activities in Ukraine have focused on reinforcing pluralism and transparency in the political process, implementing the rule of law, strengthening civil society and NGOs, assisting in the development of local government, and supporting independent media. Anticipating that the 2004 Presidential and 2006 Parliamentary elections would be pivotal for the democratic development of Ukraine, USAID launched a comprehensive elections assistance strategy prior to this period, focusing on developing the essential elements of a transparent and free electoral process. First, creating the foundation for democratic elections, USAID projects worked on the development of the legal and regulatory framework. USAID-funded projects conducted extensive voter education activities aimed at providing citizens with the opportunity to make informed and free choices. These programs specifically targeted groups, such as youth, who have historically been least politically active and rural women, who suffer most from lack of access to information, although they vote in high numbers. During the elections, USAID-trained party observers and independent monitors identified violations at polls. USAID-trained civic activists helped to organize the massive public demonstrations that led to the Orange Revolution.

Kyrgyzstan (2005): For the February 2005 parliamentary elections, USAID supported a number of activities designed to provide increased oversight over the electoral process and to encourage voter participation. USAID sponsored both international and domestic election monitoring, efforts to provide checks on the official result including exit polls and a parallel vote count, the training of poll workers, and the use of indelible ink for voters' fingers to prevent multiple voting. As in Georgia and Ukraine, all of these efforts made Kyrgyzstan's citizens more capable of rejecting a corrupt government's attempts to manipulate an election.

Legacy Institutions on Political Process: USAID has been a leader in developing and supporting a region-wide electoral process 'watchdog' organization – the European Network of Election Monitoring Organizations (ENEMO). This association is comprised of 17 different election monitoring non-governmental organizations from across Europe and Eurasia. All of these organizations have individually received USAID support in the past, either through the National Democratic Institute or directly. ENEMO has already played an important role in conducting election observations missions in Ukraine, Kyrgyzstan, and Albania.

Independent Media Development: The E&E region enjoys more sustainable, professional, and independent media systems due to the assistance USAID has provided since 1991. The Media Sustainability Index, developed by USAID/E&E and published by the International Resource & Exchanges Board (IREX), has shown steady progress for most countries in Eastern Europe, including the revolutionary countries of Georgia, Ukraine, and Kyrgyzstan. The more autocratic governments in Central Asia and Belarus—and increasingly Russia—are taking increasingly powerful actions against the media. USAID and its partners will continue to support independent media and associations of media professionals to promote an informed citizenry, thereby laying a foundation for eventual decentralized government control.

USAID/E&E's media program has shown innovation in these most difficult situations, including helping to develop alternative means of providing information, like external broadcasting, web-based transmission, satellite TV/radio and other media.

Civil Society Development: One lasting legacy of E&E's civil society programs is an improved legal environment regulating NGOs and the advocacy capacity within the sector. Through our partnership with the International Center for Not-for-Profit Law, we have simplified registration procedures, limited state involvement in NGO operations, and encouraged domestic philanthropy. Innovative new laws have been passed in some Eastern European countries, allowing taxpayers to direct 1-2 percent of their taxes to NGOs. USAID's E&E bureau is at the forefront of creative thinking and analysis of sustainability of the independent NGO sector and leads other donors in this regard. While other donors tend to limit their support to project activities, USAID focuses on capacity building and organizational development to ensure future sustainability of the sector. The E&E NGO Sustainability Index (NGOSI) is an innovative research tool that measures seven different dimensions of NGO sustainability, including legal environment, organizational capacity, advocacy, financial viability, service provision, infrastructure, and public image. After 9 years of publication, the NGOSI is an unparalleled source for information on NGO trends in E&E.

Rule of Law Development: At the most fundamental level, such previously foreign concepts as constitutionalism, separation of powers, and judicial independence have become a part of the regular vocabulary of judges, lawyers, and citizens of the region. The structural reforms and training programs supported by USAID are changing the way the law is administered. This means not only substantially enhanced rights for citizens but also access to a peaceful means of resolving conflicts. While the transition to the rule of law remains incomplete, significant progress has been made, especially considering that only a decade has passed since these countries began their transitions to democracy. By building on these foundations and working with local partners committed to reform, USAID expects to continue making important contributions to establishing the rule of law in this enormous region, thereby bringing greater peace and prosperity to the citizens of the emerging democracies of Eastern Europe and the former Soviet Union.

Social Issues

Overview: One of the least expected consequences of post-communist transformation was a decline in living standards for many and the erosion in the stock of human capital. Freedom has come at a cost, and those who have borne that cost vary by country. In some cases the most adversely affected groups are the elderly or children; in other cases they are men and women in the prime of life. The evidence is impossible to ignore: rising mortality due to infectious disease, weakened life expectancy due to deprivation and lifestyle choices, persistently high unemployment rates, low wages creating an underclass of working poor, and the outward migration of individuals seeking better opportunities. These trends, coupled with the withering of skills among those left behind are just some of the factors which have choked off the supply of productive and energized individuals to carry reform forward.

Our current strategy goes beyond the mitigation of the negative social impact of transition toward establishment of viable social systems appropriate to market-oriented democracies. The first challenge is to halt serious health threats and reduce crises in education, labor markets and vulnerable groups. USAID is meeting this challenge:

- USAID has helped (a) control the diphtheria epidemic in Eurasia, (b) demonstrate internationally-approved and cost-effective TB control approaches, (c) offer women alternatives to abortion, (d) revolutionize care for orphans and vulnerable children, (e) strengthen pension programs for retirees, (f) improve the targeting of social benefits, and (g) make teaching methods more effective.
- In Kazakhstan, where USAID has supported tuberculosis control efforts since 1998, TB deaths have decreased 41.6% between 1998 and 2003, and the U.S. Department of Health and Human Services, through its Centers for Disease Control and Prevention, calculates that the USAID-supported TB control strategy has saved more than 20,000 lives during that time.

The second challenge is to reverse the decline in human welfare, evidenced in rising mortality rates as well as poverty levels that signal the emergence in many countries of a new underclass, the working poor. USAID is meeting this challenge where it has (a) worked toward countering the deadly impact of injecting drug use, (b) developed effective HIV prevention programs, (c) revolutionized care for orphans and vulnerable children, and (d) improved the targeting of cash assistance to reach the neediest.

These and similar efforts are helping to restore basic human dignity and to sustain hope for a better future. For example:

- In Romania, USAID pioneered community-based programs to reduce abandonment and institutionalization of children. The steady decline in the number of children abandoned in institutions over the past decade -- from over 100,000 to just over 24,000 -- demonstrates increased effectiveness of community services provided to vulnerable groups. In the past year alone, 11,300 more children received community services than the year before, bringing the total number in community care to more than 76,800.

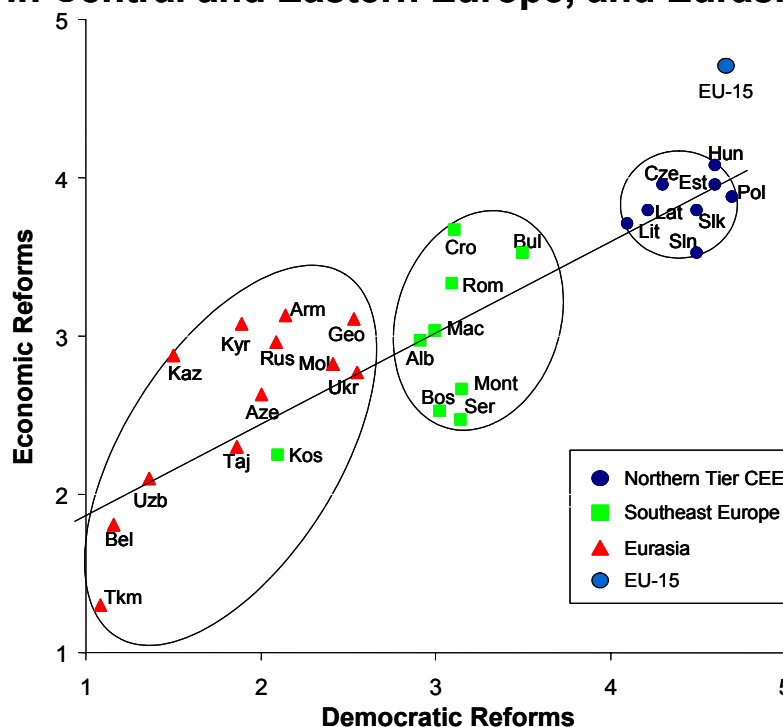
The third challenge is to transform social policies and systems, giving citizens the ability to manage risk and to access opportunities themselves, thus strengthening their human capacity and reducing their dependency on the State. The collapse of communism not only left behind an ill-equipped labor force, but an unwieldy and inefficient set of bureaucracies whose policies in health care, education, labor and retirement made it difficult for ordinary citizens to secure their personal well-being. USAID is meeting this challenge by supporting bold systemic reforms, where it has (a) made teaching methods more effective, (b) recalibrated pension systems and introduced private retirement accounts, (c) reoriented health systems toward primary and preventive care, and (d) revised labor codes to reduce labor market rigidities. For example:

- In Armenia, systemic reforms to the social welfare system introduced a social security card to every citizen, and improvements in means testing led to the better targeting of cash assistance to the neediest populations, thereby decreasing the percentage of households living in absolute poverty.
- In Macedonia, a country which four years ago stood on the brink of civil war, USAID has reshaped the education system at all levels, introducing computerization and broadband internet access into classrooms to help students acquire the diversity and level of skills needed to compete in the global economy.

The USAID Program

USAID's principal goal within the E&E region remains the establishment of functioning democracies that have open, market-oriented economic systems and responsive social safety nets. We will work to address the large disparities among E&E countries that exist in progress toward economic and democratic reforms (see the following chart). The eight countries of the European Northern Tier are well advanced in their transition to market-oriented democracies. Southeastern European countries have been plagued by instability from ethnic conflict throughout much of the 1990s and the disintegration of Yugoslavia. However, in recent years, reform progress among these countries has been impressive. In contrast, reform progress has lagged considerably in many Eurasian countries, particularly in democratization.

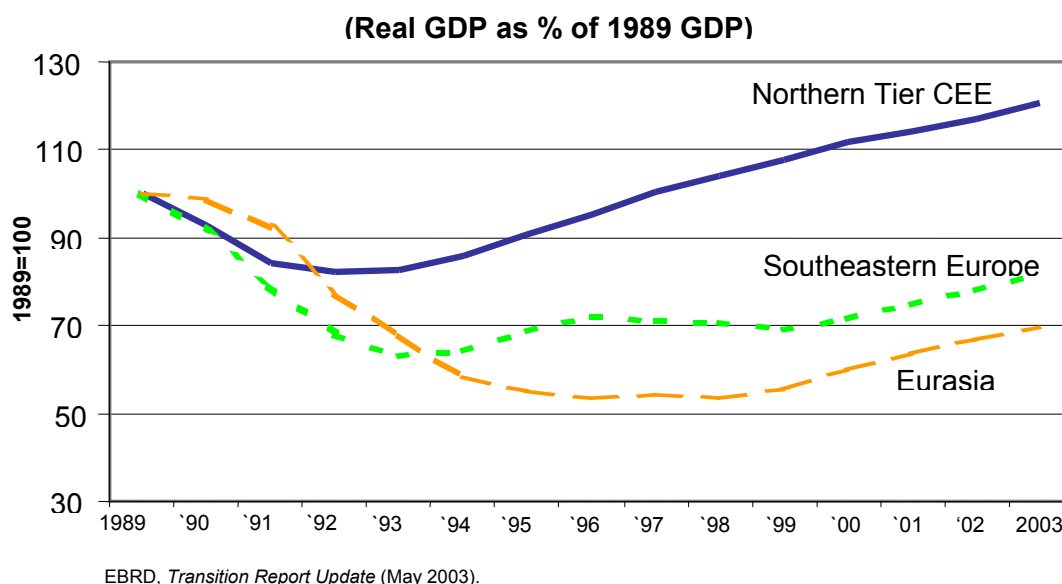
Economic Reforms and Democratic Freedoms in Central and Eastern Europe, and Eurasia: 2004



Ratings are based on a 1 to 5 scale, with 5 representing most advanced, drawing from Freedom House, *Nations in Transit 2004* (2004), and EBRD, *Transition Report 2004* (November 2004).

Assistance Area 1. Economic Prosperity and Security

Across the E&E region, per capita income in 2003 is only one-fourth the average of advanced European economies, despite 5.2 percent annual economic growth since year 2000. Among E&E countries, only the CEE Northern Tier has sustained healthy annual rates of economic growth over an extended period of time (averaging 4 percent since the mid-1990s). This has been sufficient to raise GDP in that sub-region 20 percent above 1989 levels (please see the chart below). On the other hand, in 2003, GDP in Southeastern Europe averaged about 10 percent below 1989 levels, and, in Eurasia, it averaged 30 percent below. Still, since 1999, economic growth has been the highest in Eurasia, though driven by factors, some of which may not last, including price increases for primary product exports (energy, metals, and cotton) and devaluations following the 1998 Russian financial crisis. Economic progress in the western Balkans countries, as well, remains fragile, due to weak global integration (small export sectors and little foreign direct investment).



Several E&E countries view agriculture and related rural enterprise development as potential sources of growth. However, rural economies in many of these countries have been held back by relatively poor market infrastructure, excessive State controls, and lack of access to finance. These problems are exacerbated by agriculture subsidies imposed by the developed world that undermine the international competitiveness of E&E agricultural products.

While the share of the economy controlled by the private sector has increased very impressively in nearly all E&E countries (excluding Belarus, Bosnia-Herzegovina, Serbia and Montenegro, Turkmenistan, and Uzbekistan), the international competitiveness of economies has shown little improvement, particularly so in Eurasia where monopolistic markets often prevail. In general, private enterprise in the region is inadequately prepared to participate in the global economy. Old systems for supplying inputs and for collecting and distributing products have collapsed, and new ones have yet to emerge. Institutions that support and regulate markets are weak.

Unemployment looms large as an issue, especially in Southeastern Europe where rates on average exceeded 20 percent in 2003, including a whopping 42 percent in Bosnia-Herzegovina. In Eurasia, while official unemployment rates are generally in the single digits, the region is characterized by considerable underemployment. Many workers in the region either have (a) poor-paying jobs in the informal sector or (b) employment with state enterprises in which there is little actual work or pay. Generally speaking, youth in both sub-regions are disproportionately affected.

More generally, E&E will target small and medium enterprise (SME) development across most of its recipient countries. Engines of economic growth, competitive SMEs can increase productivity, create jobs, provide incomes for an emerging middle class, and spearhead integration into regional and global economic systems. To stimulate SME growth, E&E will focus on (a) policy issues and (b) the development of clusters providing for enhanced competitiveness through the forging of linkages between economic agents and institutions. SME growth also depends on the adequacy and availability of appropriate labor skills. Hence, workforce development programs may be pursued to make SMEs more productive and competitive.

An important aspect of SME development is country performance in agriculture. As governments reform, we will increasingly move within the agricultural sector from working on policy issues to the development of markets, both internal and external. Within our market development work, competitiveness will increasingly emerge as a thrust.

For selected SEED and FSA middle-income countries (Albania, Bosnia-Herzegovina, Bulgaria, Croatia, Kazakhstan, Macedonia, Romania, Russia, and Serbia), a big push will be made to integrate them into global markets. These countries are better prepared to enter global markets. Hence, trade and investment promotion will take precedence in these countries.

Most first stage economic reforms (liberalization of domestic prices, trade, and foreign exchange regimes and small-scale privatization) have been accomplished, except in the three Eurasian weak-performers (Tajikistan, Turkmenistan, and Uzbekistan). Therefore, most remaining policy assistance will emphasize second stage reforms that focus on building market-based institutional capacity and better public governance.

For their part, commercial law and property rights adjudication, important keys to the promotion of foreign investment, constitute complex issues that will be pursued across all our recipients, especially those recipients that possess a deep commitment to reform.

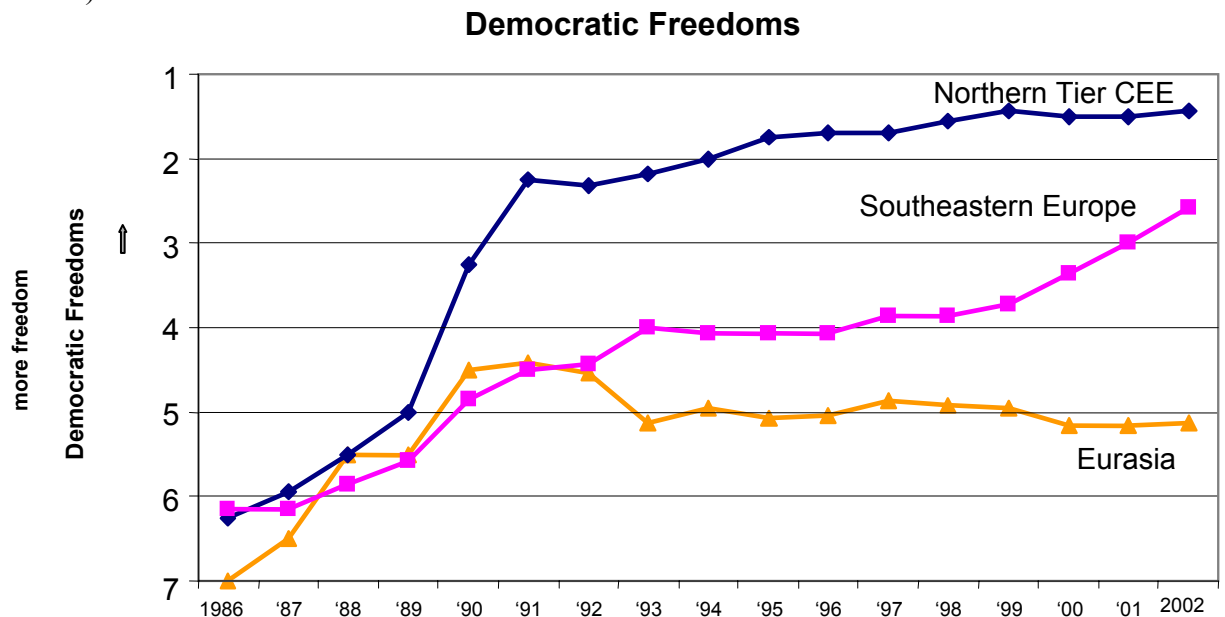
We also have much unfinished work in the energy sector. Energy is an extremely important issue for E&E, and E&E Missions must remain engaged. Energy sectors are large especially in our Eurasian recipients, owing to their significant petroleum and natural gas sectors. Energy sectors also pose a major drain on government resources. Until energy sectors are reformed and efficiency gains realized, governments will not be able to devote the resources needed to address other critical problems, e.g., health and education. The deterioration of

heating systems and the affordability of heat to the poor remain major economic and social problems in some countries.

Assistance Area 2. Democracy and Human Rights

Although much of the region has not yet achieved the prosperity, peace, and security expected in the post-Soviet era, the level of personal freedom that exists today is well beyond what millions in this region knew for decades, and people do not want to lose these freedoms. For the most part (with the exception of Belarus, Turkmenistan, and Uzbekistan), the totalitarian impulse to interfere with citizens' private matters (beliefs, choice of work, travel, etc.) is no longer pervasive. Sadly, however, among many Eurasian countries, a regression toward authoritarian patterns of political authority is perceived in a number of areas, including constraints on freedom of the press, restrictions on political activity and competition, executive influence over judiciaries, and discrimination against minority religions. Significantly, Russia dropped in Freedom House's rankings in its global survey of democratic freedoms from "partly free" to "not free" in 2004.

The remaining challenges facing democracy and governance are generally far greater in Eurasia than in Southeastern Europe. Since the collapse of the Soviet Union, democratic freedoms have generally stagnated in most of Eurasia, and the gap between Europe and Eurasia in building democracy continues to widen (please see chart below).



Data are from Freedom House, and are an aggregation of Freedom House's political rights and civil liberties indices. They come from Freedom House, *Freedom in the World 2003* (July 2003) and previous editions. Ratings from 1 to 7, with 1 representing greatest development of political rights/civil liberties.

Because democratic reforms are stalled or regressing in most countries in Eurasia except Georgia, Ukraine, and perhaps Kyrgyzstan, most areas of assistance in democracy and human rights will be emphasized in that region, including municipal governance, rule of law, independent media, civil society including human rights advocacy, and political party development and elections. Especially important in the coming year will be assistance to support elections that meet OSCE standards in countries such as Azerbaijan, Kyrgyzstan,

Albania, and Macedonia. Southeastern Europe is relatively advanced in civil society and electoral processes, so in that sub-region the other forms of democracy and governance assistance will receive greater emphasis.

Ethnic Extremism and Islam

Ethnic and religious extremism is a major source of instability in several sub-regions within E&E. In particular, we need to encourage Muslim leaders to be a source of stability within the region. Several of our recipients' governments actively discriminate against Muslim communities, a development that encourages radicalism. Decreasing the destabilizing role that extremism plays in Muslim communities can be best accomplished through encouraging economic, democratic, and social development, since extremist behavior is often linked to socially, economically, and politically disenfranchised populations. We will consider institutional mechanisms that encourage all citizens to feel that they are part of the State and educational and communication programs that promote the discussion and advancement of democracy, religious freedom, and economic liberty within the context of both secular and religious world views.⁵ USAID already has active programs to reduce tensions between or discrimination against ethnic and religious groups in Kosovo, Macedonia, Uzbekistan, and elsewhere. E&E also will fund research to monitor such discrimination.

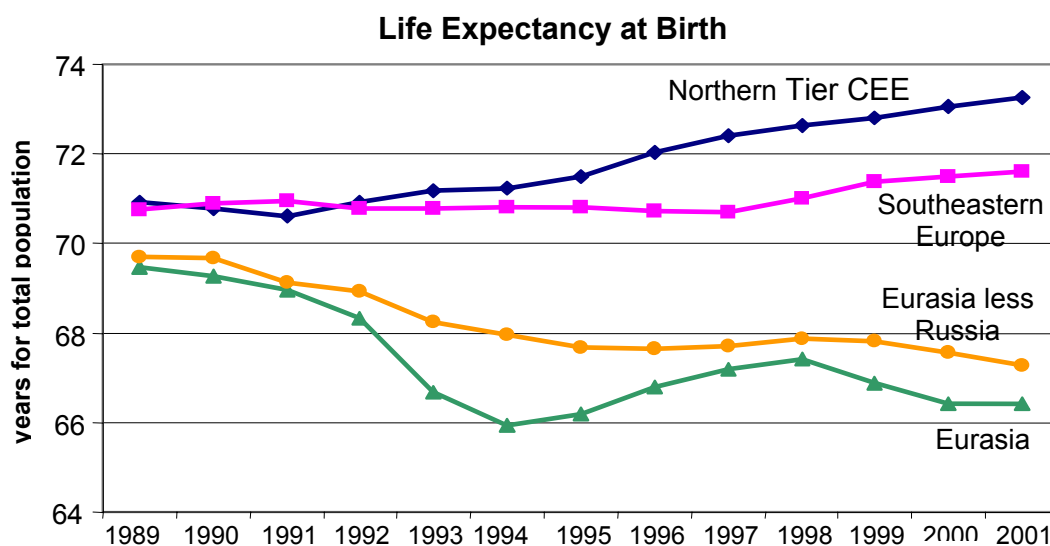
In addition, we are especially cognizant of the need to provide for meaningful employment opportunities in Muslim-majority countries and regions such as Albania, Central Asia, and the North Caucasus. Absent political rights, jobs, and hope, segments of these populations are more vulnerable to extremist rhetoric and may be drawn to terrorism.

Assistance Area 3. Social and Environmental Issues

Early assumptions that Soviet health and education sectors and social safety nets for vulnerable groups would survive and sustain the transition have often proven false. Indeed, the social transition has produced very disappointing indicators, revealing widespread declines in many aspects of health and education, degradation or elimination of social safety nets, and increased vulnerability of youth and other social groups. The fact that the majority of people in many E&E countries today are living less well materially than they did before the Soviet bloc crumbled threatens to undermine constituencies for economic and democratic reform in countries where people fail to perceive benefits from those reforms.

The difference between the Southeastern European and Eurasian sub-regions in health indicators demonstrates an especially alarming pattern of decline which is summarized starkly by divergence in life expectancy (please refer to the chart below). Life expectancy is rising in Southeastern Europe and falling in Eurasia. Based on data for 2002 – the latest available, the largest gender differences in life expectancy worldwide also are found in Eurasian countries. Russian females with a life expectancy of 72, for example, live 13 years longer than Russian males (59 years). In contrast, the spread is 6 years in Western Europe and 7 years in the European Northern Tier countries. In sum, while in 2002 life expectancies averaged between 72 and 74 years in Southeastern Europe, they stood between 65 and 69 years in Eurasia. The rapid spread of infectious diseases combined with lifestyle behaviors and resultant diseases are contributing greatly to the health crisis in Eurasia.

⁵ See *Strengthening Education in the Muslim World*, PPC, June 2003.



World Bank, *World Development Indicators 2003* (April 2003). Missing data were estimated by interpolation.

Major health risks or demographic pressures that threaten the sustainability of reform include:

- fast growing HIV rates, particularly in Russia, the Western NIS states (Belarus, Moldova, and Ukraine), and the Baltic countries (Estonia, Latvia, and Lithuania);
- a tuberculosis (TB) epidemic that continues to soar and is exacerbated by increases in HIV/TB co-infection and Multi-Drug Resistant TB, such problems being most salient in the Central Asian Republics (CARs), notably Kazakhstan (the other CARs are the Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan);
- high infant and child mortality rates in the CARs and the Caucasus (Armenia, Azerbaijan, and Georgia);
- continued high rates of abortion and maternal morbidity in Azerbaijan, the CARs, Georgia, Moldova, and Romania;
- aging and shrinking populations combined with declining life expectancy in Eurasia;
- the decline in the capacity of health finance and delivery systems to address the evolving epidemiology and demographics;
- cardiovascular and other non-communicable diseases that account for three-fourths of all deaths (many prematurely); and
- little attention to disease prevention and continued risky behaviors that reduce life expectancy.

The stock of human capital varies considerably across countries -- highest in Slovenia (and the other European northern tier countries) and lowest in Tajikistan (and in the remaining CARs and the Caucasus). Some indicators allow optimism that the worst of the social deterioration already may have occurred. For example, trends in real wages and, possibly, education expenditures and secondary school enrollment shares (the share of the population aged 15 to 18 that is attending secondary school) are slowly improving in a majority of E&E countries. Secondary school enrollment shares had declined in Eurasian countries from 60-70

percent in 1989 to 30-40 percent in the early 2000s; declines, albeit not as great, also had taken place in these same countries at the primary level.

Health will be an increasing concern for all E&E's Missions, building on USAID experience to date. High abortion rates and low contraceptive rates throughout the region require continued attention to reproductive health in most E&E countries. E&E will focus on child survival and maternal health interventions in countries of greatest need. The Caucasus countries and the CARs have the highest under-five mortality rates in the transition region. Almost all our recipients are encountering difficulties with infectious diseases, including HIV/AIDS and tuberculosis (TB). HIV/AIDS and TB funds will be targeted toward countries with high infection rates, notably Russia, Ukraine, and Central Asia. E&E will examine proven, practical and affordable interventions to address non-communicable diseases. Work in health systems and administration will be undertaken in countries with a commitment to reform, e.g., Albania and Uzbekistan, although it also could be pursued in other countries to build commitment and improve system efficiencies.

Especially through further collaboration with the World Bank and other donors, education assistance to selected countries/entities in Eurasia (Azerbaijan, Tajikistan, Turkmenistan, and Uzbekistan) and Southeastern Europe (Kosovo, Macedonia) has particularly high long-term potential. E&E will continue its existing basic and secondary education program in Central Asia, with vocational education an added emphasis in selected countries. Also, general university education in countries where E&E has already established a role, e.g., selected middle income Southeastern European countries, will be supported, in addition to university-level business management education.

We will address social protection and labor issues. E&E also will sponsor workforce competitiveness studies that identify skills training and labor market reforms required to spur economic growth. Finally, social sector reforms to deal with corruption will be an important element of E&E's programs; we will seek to eliminate rent-seeking in the delivery of services in both the health and education sectors.

Cross-cutting Assistance Areas

While some of the most important USAID priorities do not easily fall into the above three assistance areas, they are indispensable for achieving our basic goals. These areas include values and social capital, corruption, trafficking in persons, and conflict.

Values and social capital

USAID has always recognized that sustainable development is strongly supported by widespread acceptance among the beneficiary population of certain values necessary to the fair and efficient functioning of the State and the economy. To provide for values supportive of economic, democratic, and social development, E&E programs will more consistently seek ways to build social capital. The term "social capital" refers to the prevalent mindset that results in voluntary compliance with established laws, trust, cooperative behavior, and basic codes of conduct.⁶

⁶ The phrase "social capital" has been used in recent times by many scholars (e.g., James Coleman, Francis Fukuyama, Robert Putnam, etc.) and institutions (e.g., the European Bank for Reconstruction and Development,

Social capital has deteriorated significantly in the E&E region since the transition began a decade and a half ago. Academic analysts, news media, and donors have generally underestimated the degree to which weak social capital in the former Soviet Union and the Eastern Bloc has undermined efforts to promote democratic and economic reform. Differences in the stock of social capital account for the pattern across the E&E region in which countries that experienced a longer and deeper exposure to communism have shown a slower pace of reform in the post-Soviet era.

Our task is to seek ways to append a values and social capital enhancement dimension to existing programs. Likely involving more attention to youth, possible program areas include:

- values education, including the development of curricula in the area of character education. Materials could be gathered and disseminated which rely on indigenous historical, literary, religious, and political figures who embody the values that need to be cultivated such as integrity and honesty;
- exchange programs and training exercises that promote ethnic and religious tolerance;
- media projects, both written and visual, which feature leadership and visionary characteristics; and
- activities that strengthen civil society relationships. Positive values will emerge when citizens participate in civil society structures and see the benefits they bring.

Corruption

Corruption is endemic to much of the E&E region. The corruption index compiled by Freedom House scores 17 E&E countries at five or higher on a scale where “7” represents the worst level. Recent surveys confirm that citizens view endemic corruption as one of the region’s most serious societal problems, ranking close behind poverty, political instability, and crime. In the presence of corruption, the Bureau’s transition goals (democracy, economic, and social) have been slowed or blocked. In sum, while programs directed specifically at reducing corruption may be undertaken, an orientation toward reducing corruption will run through numerous programs in countries where it is a widespread problem.

The E&E strategic approach to addressing corruption promotes transparency, accountability, prevention, enforcement, and education. We are promoting transparency through our work to create open, participatory governments. We promote accountability through support of (a) checks and balances amongst government branches and from outside sources such as independent media, trade associations, and political parties, (b) inspector general functions, and (c) the decentralization of power to other layers of government. Our programs support prevention of corruption through the systemic reform of institutions and laws to decrease opportunities and incentives for rent-seeking behavior. USAID is working to promote enforcement through the consistent application of effective standards and prohibitions. Finally, USAID programs support educational efforts that point out the adverse consequences of corruption, the tangible benefits of reform, and the concrete potential for positive change. Our approach to corruption also relies on USAID’s new agency-wide Anti-corruption

the International Monetary Fund, and the World Bank).

Strategy.

Combating Trafficking in persons (TIP)

TIP is a major issue in the E&E region. It is estimated that as many as 25 percent of TIP victims globally come from this region. The E&E Bureau views trafficking in persons (TIP) as an economic problem and a violation of human rights. Combating TIP requires action in the E&E goal areas as well as in both regional and country programs. Targeted TIP efforts complement an array of other development efforts that address the underlying factors which give rise to TIP in this region including: a) socio-economic dislocation; b) corruption and a breakdown in values; c) disenfranchisement of substantial populations, especially along ethnic and gender lines; d) organized crime; e) regional conflict, including participation by international peace keepers; f) the demand for sexual exploitation and excessively cheap, illegal or legally unprotected labor.

Some Missions already address TIP through activities in local government, SME development, civil society, media, gender, health, and rule of law. When targeting TIP, USAID efforts should focus primarily on:

- prevention of TIP, through economic empowerment; crisis prevention; public education and awareness; capacity building of government, NGOs and the media; and legal reform and implementation; and
- protection of victims through support of government and NGO referral services and victim witness protection

Conflict Management and Mitigation

In the wake of the collapse of the Soviet bloc, political and ethnic tensions have risen and fueled bloody conflict in the name of national and ethnic liberation. For example, between 1991 and 1995, hundreds of thousands of people lost their lives in violence associated with the break-up of Yugoslavia. The E&E Bureau has integrated its conflict mitigation efforts within its work in each of the three transition subject areas. In order to address conflict vulnerabilities, we encourage programming that implicitly builds social cohesion, communication, and understanding. This type of programming might include regional cooperation, the promotion of economic growth via SME development, the empowerment of communities through the collective resolution of practical local issues, support for civil society advocacy actions, the engagement of idle youth, the decentralization of government for improved service delivery at the local level, and the promotion of transparency by strengthening actors and institutions related to the rule of law. Notable activities include tolerance projects in both Bosnia-Herzegovina and Russia and the assessments for Kosovo and Serbia and Montenegro led by the Agency's Conflict Management and Mitigation Office.

The Millennium Challenge Account (MCA)

Signed into law on January 23, 2004 by President Bush, the MCA is designed to provide additional assistance to countries that have met specific indicators related to ruling justly, investing in their people, and encouraging economic freedom. With strong bipartisan support, Congress authorized the Millennium Challenge Corporation (MCC) to administer the MCA and provided \$1 billion in initial funding for FY 2004. President Bush's request for the MCA in FY 2005 was \$2.5 billion, of which Congress appropriated \$1.5 billion. For FY 2006, the

President has requested funding of \$3 billion to help reduce poverty through measurable results and preserve the strong incentive for positive policy reforms throughout the world.

The MCC, which administers the MCA and for which USAID Administrator Natsios is a board member, met in May 2004 and identified sixteen countries as eligible for MCA assistance, including Armenia and Georgia from the E&E region. On Monday, September 12th, the MCC signed a five-year \$295.3 million compact with Georgia to reduce poverty and stimulate economic growth in the regions outside of Georgia's capital, Tbilisi, where more than 50 percent of rural households live below the poverty line. By focusing on rehabilitating regional infrastructure and promoting private sector development, the program will directly benefit approximately a half-million Georgians.

The MCC Board also approved a “Threshold Country” program which will be directed towards a number of countries that have not met the requirements for MCA eligibility but demonstrate significant commitment to meeting those requirements. From the E&E region, the Board selected Albania to be eligible for threshold country status. New candidacy criteria for FY 2006 may provide MCA-eligibility and threshold status for more E&E countries.

All USAID Missions in the E&E region will work to encourage our recipient countries to focus on MCA’s criteria of ruling justly, encouraging economic freedom, and investing in people.

Phase Out of USG Assistance

The United States Government always has planned that assistance to the Europe and Eurasia region would be temporary, lasting only long enough to ensure successful transition to sustainable, market-oriented democracies with responsive social safety nets. The performance of Bulgaria and Romania in FY 2002, the year the two countries were notified that they would be accepted into NATO, is used as a threshold, representing sufficient transition performance to phase out SEED and FSA assistance. Accession to NATO demonstrated that the two countries had progressed to the point that they had reached the irreversible path to becoming market-oriented democracies. USAID/E&E’s Monitoring Country Progress system provided the analytical base for systematic interagency review led by EUR/ACE to establish time frames for the phase-out of USG assistance in all our recipient countries. Through this interagency analytical process, phase-out dates have been projected for each of the economic, democratic, social, and law enforcement sectors for our Southeastern European and Eurasian recipient countries. These phase-out dates have been identified for planning purposes and do not convey any commitment to funding levels or entitlement to assistance until the established dates. USAID/E&E’s Bureau also uses these data to adjust strategies to address remaining gaps and maximize the impact of USG assistance.

Over the next several years, three country programs will graduate and their Missions will close, including Bulgaria, Croatia, and Romania. In addition, we plan to phase out of the economic sectors in Kazakhstan, Russia, and Ukraine over the next several years. These decisions all assume that performance continues as projected. Across all the region’s countries, E&E will monitor closely transition indicators using the Bureau’s MCP system as

well as Mission and Bureau staff understanding of problems, progress, and prospects in each sector to periodically re-assess the phase-out dates.

Cyprus, Northern Ireland and the Republic of Ireland, and Turkey

The E&E Bureau also administers Economic Support Fund (ESF) allocations for Cyprus, Northern Ireland and the Republic of Ireland, and Turkey, and the FY 2006 request includes \$42 million in such allocations. Turkey, as a front line state against the war on terrorism, will benefit from \$10 million under the FY 2006 request; Cyprus, \$20 million; and Northern Ireland and the Republic of Ireland, \$12 million. For FY 2005, \$13.4 million had been appropriated for Cyprus; \$21.8 million for Northern Ireland and the Republic of Ireland; and zero for Turkey. Turkey, however, had received \$10 million in FY 2004, which funded activities including: (a) support for a World Bank pre-natal care and education activity under the Bank's Social Risk Mitigation Project; (b) an International Organization for Migration anti-trafficking activity; and (c) a business partnering program implemented through a contractor to be determined. As for Cyprus and Northern Ireland, past allocations have supported reconciliation and conflict resolution amongst communities in conflict. Funds Cyprus received by USAID in the past have supported partnership activities to promote economic growth in the Turkish Cypriot community, and bicomunal cooperation among all Cypriots on initiatives that benefit the island as a whole and that promote understanding and reconciliation, leading to a broad political settlement based on a bizonal, bicomunal framework.

Conclusions

We are proud of our successes in the E&E region, a region that remains of considerable foreign policy importance to the United States. Our programs, which are integrated into the frameworks set by the National Security Strategy, the Joint State/USAID strategy, and the USAID "White Paper," have permitted us since the fall of the Iron Curtain to make tremendous strides in furthering democracy, installing market-based economic systems, and tending to the social and humanitarian needs of the former communist states of Europe and Eurasia. We are very aware that there is much left to be done. In particular, the post-Soviet states of Eurasia appear to have a long transition path ahead of them. As new priorities emerge in other parts of the world, I would urge the distinguished members of the House International Relations Committee to support our Budget and Operating Expense requests that are focused, for the most part, on countries that demonstrate a commitment to sound development principles and democracy. Allocations at such levels would help us to achieve our overriding goal in the region – the establishment of market-oriented democracies with responsible social safety nets. Our very close working relationships with the State Department Coordinator would allow us to program resources in a way that would help us meet that goal.

Finally, it is imperative that our work stay the course, despite the difficulty of the task and the occasional bumps along the way. After a decade and a half working in the region, we have learned that premature disengagement can have enormous costs in the long run. Transitions in this region cannot happen overnight. Many of our programs have long gestation periods. A case in point is Ukraine. We spent a number of years building up civil society, and a

mature civil society together with timely elections assistance were the key tools that the country's populace required to carry out the largely successful "Orange" Revolution.

In the end, final victory can only be secured by the will of the people, not by the assistance of international donors. We can, however, be a responsible supporter of the aspirations of free people and those that long for freedom.

Thank you, Mr. Chairman.